

§ 1.337(d)-1

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EFFECTS ON CORPORATION

§ 1.337(d)-1 Transitional loss limitation rule.

(a) *Loss limitation rule for transitional subsidiary*—(1) *General rule.* No deduction is allowed for any loss recognized by a member of a consolidated group with respect to the disposition of stock of a transitional subsidiary. However, for transactions involving loss shares of subsidiary stock occurring on or after September 17, 2008, see § 1.1502-36. Further, this section does not apply to a transaction that is subject to § 1.1502-36.

(2) *Allowable loss*—(i) *In general.* Paragraph (a)(1) of this section does not apply to the extent the taxpayer establishes that the loss is not attributable to the recognition of built-in gain by any transitional subsidiary on the disposition of an asset (including stock and securities) after January 6, 1987.

(ii) *Statement of allowable loss.* Paragraph (a)(2)(i) of this section applies only if a separate statement entitled “Allowable Loss Under § 1.337(d)-1(a)” is filed with the taxpayer’s return for the year of the stock disposition. If the separate statement is required to be filed with a return the due date (including extensions) of which is before January 16, 1991, or with a return due (including extensions) after January 15, 1991 but filed before that date, the statement may be filed with an amended return for the year of the disposition or with the taxpayer’s first subsequent return the due date (including extensions) of which is after January 15, 1991.

(iii) *Contents of statement.* The statement required under paragraph (a)(2)(ii) of this section must contain—

(A) The name and employer identification number (E.I.N.) of the transitional subsidiary.

(B) The basis of the stock of the transitional subsidiary immediately before the disposition.

(C) The amount realized on the disposition.

(D) The amount of the deduction not disallowed under paragraph (a)(1) of this section by reason of this paragraph (a)(2).

(E) The amount of loss disallowed under paragraph (a)(1) of this section.

(3) *Coordination with loss deferral and other disallowance rules.* (i) For purposes of this section, the rules of § 1.1502-20(a)(3) apply, with appropriate adjustments to reflect differences between the approach of this section and that of § 1.1502-20.

(ii) *Other loss deferral rules.* If paragraph (a)(1) of this section applies to a loss subject to deferral or disallowance under any other provision of the Code or the regulations, the other provision applies to the loss only to the extent it is not disallowed under paragraph (a)(1).

(4) *Definitions.* For purposes of this section—

(i) The definitions in § 1.1502-1 apply.

(ii) *Transitional subsidiary* means any corporation that became a subsidiary of the group (whether or not the group was a consolidated group) after January 6, 1987. Notwithstanding the preceding sentence, a subsidiary is not a transitional subsidiary if the subsidiary (and each predecessor) was a member of the group at all times after the subsidiary’s (and each predecessor’s) organization.

(iii) *Built-in gain* of a transitional subsidiary means gain attributable, directly or indirectly, in whole or in part, to any excess of value over basis, determined immediately before the transitional subsidiary became a subsidiary, with respect to any asset owned directly or indirectly by the transitional subsidiary at that time.

(iv) *Disposition* means any event in which gain or loss is recognized, in whole or in part.

(v) *Value* means fair market value.

(5) *Examples.* For purposes of the examples in this section, unless otherwise stated, the group files consolidated returns on a calendar year basis, the facts set forth the only corporate activity, and all sales and purchases are with unrelated buyers or sellers. The basis of each asset is the same determining earnings and profits adjustments and taxable income. Tax liability and its effect on basis, value, and earnings and profits are disregarded. *Investment adjustment system* means the rules of § 1.1502-32. The principles of this paragraph (a) are illustrated by the following examples:

Example 1. Loss attributable to recognized built-in gain. (i) P buys all the stock of T for \$100 on February 1, 1987, and T becomes a member of the P group. T has an asset with a value of \$100 and basis of \$0. T sells the asset in 1989 and recognizes \$100 of built-in gain on the sale (*i.e.*, the asset's value exceeded its basis by \$100 at the time T became a member of the P group). Under the investment adjustment system, P's basis in the T stock increases to \$200. P sells all the stock of T on December 31, 1989, and recognizes a loss of \$100. Under paragraph (a)(1) of this section, no deduction is allowed to P for the \$100 loss.

(ii) Assume that, after T sells its asset but before P sells the T stock, T issues additional stock to unrelated persons and ceases to be a member of the P group. P then sells all its stock of T in 1997. Although T ceases to be a subsidiary within the meaning of § 1.1502-1, T continues to be a transitional subsidiary within the meaning of this section. Consequently, under paragraph (a)(1) of this section, no deduction is allowed to P for its \$100 loss.

Example 2. Loss attributable to post-acquisition loss.

P buys all the stock of T for \$100 on February 1, 1987, and T becomes a member of the P group. T has \$50 cash and an asset with \$50 of built-in gain. During 1988, T retains the asset but loses \$40 of the cash. The P group is unable to use the loss, and the loss becomes a net operating loss carryover attributable to T. Under the investment adjustment system, P's basis in the stock of T remains \$100. P sells all the stock of T on December 31, 1988, for \$60 and recognizes a \$40 loss. Under paragraph (a)(2)(i) of this section, P establishes that it did not dispose of the built-in gain asset. None of P's loss is disallowed under paragraph (a)(1) if P satisfies the requirements of paragraph (a)(2)(ii) of this section.

Example 3. Stacking rules—postacquisition loss offsets postacquisition gain. (i) P buys all the stock of T for \$100 on February 1, 1987, and T becomes a member of the P group. T has 2 assets. Asset 1 has a basis and value of \$50, and asset 2 has a basis of \$0 and a value of \$50. During 1989, asset 1 declines in value to \$0, and T sells asset 2 for \$50, and reinvests the proceeds in asset 3. The value of asset 3 appreciates to \$90. Under the investment adjustment system, P's basis in the stock of T increases from \$100 to \$150 as a result of the gain recognized on the sale of asset 2 but is unaffected by the unrealized post-acquisition decline in the value of asset 1. On December 31, 1989, P sells all the stock of T for \$90 and recognizes a \$60 loss.

(ii) Although T incurred a \$50 post-acquisition loss of built-in gain because of the decline in the value of asset 1, T also recognized \$50 of built-in gain. Under paragraph (a)(2) of this section, any loss on the sale of

stock is treated first as attributable to recognized built-in gain. Thus, for purposes of determining under paragraph (a)(2) of this section whether P's \$60 loss on the disposition of the T stock is attributable to the recognition of built-in gain on the disposition of an asset, T's unrealized post-acquisition gain of \$40 offsets \$40 of the \$50 of unrealized post-acquisition loss. Therefore, \$50 of the \$60 loss is attributable to the recognition of built-in gain on the disposition of an asset and is disallowed under paragraph (a)(1) of this section.

Example 4. Stacking rules—built-in loss offsets built-in gain. (i) P buys all the stock of T for \$50 on February 1, 1987, and T becomes a member of the P group. T has 2 assets. Asset 1 has a basis of \$50 and a value of \$0, and asset 2 has a basis of \$0 and a value of \$50. During 1989, T sells asset 1 for \$0 and asset 2 for \$50, and reinvests the \$50 proceeds in asset 3. The value of asset 3 declines to \$40. Under the investment adjustment system, P's basis in the stock of T remains \$50 as a result of the offsetting gain and loss recognized on the sale of assets 1 and 2 and is unaffected by the unrealized post-acquisition decline in the value of asset 3. On December 31, 1989, P sells all the stock of T for \$40 and recognizes a \$10 loss.

(ii) Although T recognized a \$50 built-in gain on the sale of asset 2, T also recognized a \$50 built-in loss on the sale of asset 1. For purposes of determining under paragraph (a)(2) of this section whether P's \$10 loss on the disposition of the T stock is attributable to the recognition of built-in gain on the disposition of an asset, T's recognized built-in gain is offset by its recognized built-in loss. Thus none of P's \$10 loss is attributable to the recognition of built-in gain on the disposition of an asset.

(iii) The result would be the same if, instead of a \$50 built-in loss in asset 2, T has a \$50 net operating loss carryover when P buys the T stock, and the net operating loss carryover is used to offset the built-in gain.

Example 5. Outside basis partially corresponds to inside basis. (i) Individual A owns all the stock of T, for which A has a basis of \$60. On February 1, 1987, T owns 1 asset with a basis of \$0 and a value of \$100. P acquires all the stock of T from A in an exchange to which section 351(a) applies, and T becomes a member of the P group. P has a carryover basis of \$60 in the T stock. During 1988, T sells the asset and recognizes \$100 of gain. Under the investment adjustment system, P's basis in the T stock increases from \$60 to \$160. T reinvests the \$100 proceeds in another asset, which declines in value to \$90. On January 1, 1989, P sells all the stock of T for \$90 and recognizes a loss of \$70.

(ii) Although P's basis in the T stock was increased by \$100 as a result of the recognition of built-in gain on the disposition of T's asset, only \$60 of the \$70 loss on the sale of

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the stock is attributable under paragraph (a)(2) of this section to the recognition of built-in gain from the disposition of the asset. (Had T's asset not declined in value to \$90, the T stock would have been sold for \$100, and a \$60 loss would have been attributable to the recognition of the built-in gain.) Therefore, \$60 of the \$70 loss is disallowed under paragraph (a)(2), and \$10 is not disallowed if P satisfies the requirements of paragraph (a)(2). If P had sold the stock of T for \$95 because T's other assets had unrealized appreciation of \$5, \$60 of the \$65 loss would still be attributable to T's recognition of built-in gain on the disposition of assets.

Example 6. Creeping acquisition. P owns 60 percent of the stock of S on January 6, 1987. On February 1, 1987, P buys an additional 20 percent of the stock of S, and S becomes a member of the P group. P sells all the S stock on March 1, 1989 and recognizes a loss of \$100. All 80 percent of the stock of S owned by P is subject to the rules of this section and, under paragraph (a) (1) and (2) of this section, P is not allowed to deduct the \$100 loss, except to the extent P establishes the loss is not attributable to the recognition by S of built-in gain on the disposition of assets.

Example 7. Effect of post-acquisition appreciation. P buys all the stock of T for \$100, and T becomes a member of the P group. T has an asset with a basis of \$0 and a value of \$100. T sells the asset for \$100. Under the investment adjustment system, P's basis in the T stock increases to \$200. T reinvests the proceeds of the sale in an asset that appreciates in value to \$180. Five years after the sale, P sells all the stock of T for \$180 and recognizes a \$20 loss. Under paragraph (a)(1) of this section, no deduction is allowed to P for the \$20 loss.

Example 8. Deferred loss and recognized gain. (i) P is the common parent of a consolidated group, S is a wholly owned subsidiary of P, and T is a wholly owned subsidiary of S. S purchased all of the T stock on February 1, 1987 for \$100, and T has an asset with a basis of \$40 and a value of \$100. T sells the asset for \$100, recognizing \$60 of gain. Under the investment adjustment system, S's basis in the T stock increases from \$100 to \$160. S sells its T stock to P for \$100 in a deferred intercompany transaction, recognizing a \$60 loss that is deferred under section 267(f) and § 1.1502-13. P subsequently sells all the stock of T for \$100 to X, a member of the same controlled group (as defined in section 267(f)) as P but not a member of the P consolidated group.

(ii) Under paragraph (a)(3) of this section, the application of paragraph (a)(1) of this section to S's \$60 loss is deferred, because S's loss is deferred under section 267(f) and § 1.1502-13. Although P's sale of the T stock to X would cause S's deferred loss to be taken into account under § 1.1502-13, § 1.267(f)-1 provides that the loss is not taken

into account because X is a member of the same controlled group as P and S. Nevertheless, under paragraph (a)(3) of this section, because the T stock ceases to be owned by a member of the P consolidated group, S's deferred loss is disallowed immediately before the sale and is never taken into account under section 267(f).

(b) *Indirect disposition of transitional subsidiary*—(1) *Loss limitation rule for transitional parent.* No deduction is allowed for any loss recognized by a member of a consolidated group with respect to the disposition of stock of a transitional parent.

(2) *Allowable loss*—(i) *In general.* Paragraph (b)(1) of this section does not apply to the extent the taxpayer establishes that the loss exceeds the amount that would be disallowed under paragraph (a) of this section if each highest tier transitional subsidiary's stock in which the transitional parent has a direct or indirect interest had been sold immediately before the disposition of the transitional parent's stock. In applying the preceding sentence, appropriate adjustments shall be made to take into account circumstances where less than all the stock of a transitional parent owned by members of a consolidated group is disposed of in the same transaction, or the stock of a transitional subsidiary or a transitional parent is directly owned by more than 1 member.

(ii) *Statement of allowable loss.* Paragraph (b)(2)(i) of this section applies only if a separate statement entitled "Allowable Loss Under Section 1.337(d)-1(b)" is filed with the taxpayer's return for the year of the stock disposition. If the separate statement is required to be filed with a return the due date (including extensions) of which is before January 16, 1991, or with a return due (including extensions) after January 15, 1991 but filed before that date, the statement may be filed with an amended return for the year of the disposition or with the taxpayer's first subsequent return the due date (including extensions) of which is after January 15, 1991.

(iii) *Contents of statement.* The statement required under paragraph (b)(2)(ii) of this section must contain—

(A) The name and employer identification number (E.I.N.) of the transitional parent.

(B) The basis of the stock of the transitional parent immediately before the disposition.

(C) The amount realized on the disposition.

(D) The amount of the deduction not disallowed under paragraph (b)(1) of this section by reason of this paragraph (b)(2).

(E) The amount of loss disallowed under paragraph (b)(1) of this section.

(3) *Coordination with loss deferral and other disallowance rules.* (i) For purposes of this section, the rules of § 1.1502-20(a)(3) apply, with appropriate adjustments to reflect differences between the approach of this section and that of § 1.1502-20.

(ii) *Other loss deferral rules.* If paragraph (b)(1) of this section applies to a loss subject to deferral or disallowance under any other provision of the Code or the regulations, the other provision applies to the loss only to the extent it is not disallowed under paragraph (b)(1).

(4) *Definitions.* For purposes of this section—

(i) *Transitional parent* means any subsidiary, other than a transitional subsidiary, that owned at any time after January 6, 1987, a direct or indirect interest in the stock of a corporation that is a transitional subsidiary.

(ii) *Highest tier transitional subsidiary* means the transitional subsidiary (or subsidiaries) in which the transitional parent has a direct or indirect interest and that is the highest transitional subsidiary (or subsidiaries) in a chain of members.

(5) *Examples.* The principles of this paragraph (b) are illustrated by the following examples:

Example 1. Ownership of chain of transitional subsidiaries. (i) P forms S with \$200 on January 1, 1985, and S becomes a member of the P group. On February 1, 1987, S buys all the stock of T, and T buys all the stock of T1, and both T and T1 become members of the P group. On January 1, 1988, P sells all the stock of S and recognizes a \$90 loss on the sale.

(ii) Under paragraph (a)(4)(ii) of this section, both T and T1 are transitional subsidiaries, because they became members of the P group after January 6, 1987. Under paragraph (b)(4)(i) of this section, S is a transitional parent, because it owns a direct interest in stock of transitional subsidiaries and is not itself a transitional subsidiary.

(iii) Under paragraph (b) (1) and (2) of this section, because S is a transitional parent, no deduction is allowed to P for its \$90 loss except to the extent the loss exceeds the amount of S's loss that would have been disallowed if S had sold all the stock of T, S's highest tier transitional subsidiary, immediately before P's sale of all the S stock. Assume all the T stock would have been sold for a \$90 loss and that all the loss would be attributable to the recognition of built-in gain from the disposition of assets. Because in that case \$90 of loss would be disallowed, all of P's loss on the sale of the S stock is disallowed under paragraph (b).

Example 2. Ownership of brother-sister transitional subsidiaries. (i) P forms S with \$200 on January 1, 1985, and S becomes a member of the P group. On February 1, 1987, S buys all the stock of both T and T1, and T and T1 become members of the P group. On January 1, 1988, P sells all the stock of S and recognizes a \$90 loss on the sale.

(ii) Under paragraph (b) (1) and (2) of this section, no deduction is allowed to P for its \$90 loss except to the extent P establishes that the loss exceeds the amount of S's stock losses that would be disallowed if S sold all the stock of T and T1, S's highest tier transitional subsidiaries, immediately before P's sale of all the S stock. Assume that all the T stock would have been sold for a \$50 loss, all the T1 stock of a \$40 loss, and that the entire amount of each loss would be attributable to the recognition of built-in gain on the disposition of assets. Because \$90 of loss would be disallowed with respect to the sale of S's T and T1 stock, P's \$90 loss on the sale of all the S stock is disallowed under paragraph (b).

(c) *Successors—(1) General rule.* This section applies, to the extent necessary to effectuate the purposes of this section, to—

(i) Any property owned by a member or former member, the basis of which is determined, directly or indirectly, in whole or in part, by reference to the basis in a subsidiary's stock, and

(ii) Any property owned by any other person whose basis in the property is determined, directly or indirectly, in whole or in part, by reference to a member's (or former member's) basis in a subsidiary's stock.

(2) *Examples.* The principles of this paragraph (c) are illustrated by the following examples:

Example 1. Merger into grandfathered subsidiary. P, the common parent of a group, owns all the stock of T, a transitional subsidiary. On January 1, 1989, T merges into S, a wholly owned subsidiary of P that is not a

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transitional subsidiary. Under paragraph (c)(1) of this section, all the stock of S is treated as stock of a transitional subsidiary. As a result, no deduction is allowed for any loss recognized by P on the disposition of any S stock, except to the extent the P group establishes under paragraph (a)(2) that the loss is not attributable to the recognition of built-in gain on the disposition of assets of T.

Example 2. Nonrecognition exchange of transitional stock. (i) P, the common parent of a group, owns all the stock of T, a transitional subsidiary. On January 1, 1989, P transfers the stock of T to X, a corporation that is not a member of the P group, in exchange for 20 percent of its stock in a transaction to which section 351(a) applies. T and X file separate returns.

(ii) Under paragraph (c)(1) of this section, all the stock of X owned by P is treated as stock of a transitional subsidiary because P's basis for the X stock is determined by reference to its basis for the T stock. As a result, no deduction is allowed to P for any loss recognized on the disposition of the X stock, except to the extent permitted under paragraph (a) of this section.

(iii) Under paragraph (c)(1), X is treated as a member subject to paragraph (a) of this section with respect to the T stock because X's basis for the stock is determined by reference to P's basis for the stock. Moreover, all of the T stock owned by X continues to be stock of a transitional subsidiary. As a result, no deduction is allowed to X for any loss recognized on the disposition of any T stock, except to the extent permitted under paragraph (a) of this section.

(d) *Investment adjustments and earnings and profits*—(1) *In general.* For purposes of determining investment adjustments under § 1.1502-32 and earnings and profits under § 1.1502-33(c) with respect to a member of a consolidated group that owns stock in a subsidiary, any deduction that is disallowed under this section is treated as a loss arising and absorbed by the member in the tax year in which the disallowance occurs.

(2) *Example.* (i) In 1986, P forms S with a contribution of \$100, and S becomes a member of the P group. On February 1, 1987, S buys all the stock of T for \$100. T has an asset with a basis of \$0 and a value of \$100. In 1988, T sells the asset for \$100. Under the investment adjustment system, S's basis in the T stock increases to adjustment system, S's basis in the T stock increases to \$200, P's basis in the S stock increases to \$200, and P's earnings and profits and S's earnings and profits in-

crease by \$100. In 1989, S sells all of the T stock for \$100, and S's recognized loss of \$100 is disallowed under paragraph (a)(1) of this section.

(ii) Under paragraph (d)(1) of this section, S's earnings and profits for 1989 are reduced by \$100, the amount of the loss disallowed under paragraph (a)(1). As a result, P's basis in the S stock is reduced from \$200 to \$100 under the investment adjustment system. P's earnings and profits for 1989 are correspondingly reduced by \$100.

(e) *Effective dates*—(1) *General rule.* This section applies with respect to dispositions after January 6, 1987. For dispositions on or after November 19, 1990, however, this section applies only if the stock was deconsolidated (as that term is defined in § 1.337(d)-2(b)(2)) before November 19, 1990, and only to the extent the disposition is not subject to § 1.337(d)-2 or § 1.1502-20.

(2) *Binding contract rule.* For purposes of this paragraph (e), if a corporation became a subsidiary pursuant to a binding written contract entered into before January 6, 1987, and in continuous effect until the corporation became a subsidiary, or a disposition was pursuant to a binding written contract entered into before March 9, 1990, and in continuous effect until the disposition, the date the contract became binding shall be treated as the date the corporation became a subsidiary or as the date of disposition.

(3) *Application of § 1.1502-20T to certain transactions*—(i) *In general.* If a group files the certification described in paragraph (e)(3)(ii) of this section, it may apply § 1.1502-20T (as contained in the CFR edition revised as of April 1, 1990), to all of its members with respect to all dispositions and deconsolidations by the certifying group to which § 1.1502-20T otherwise applied by its terms occurring—

(A) On or after March 9, 1990 (but only if not pursuant to a binding contract described in § 1.337(d)-1T(e)(2) (as contained in the CFR edition revised as of April 1, 1990) that was entered into before March 9, 1990); and

(B) Before November 19, 1990 (or thereafter, if pursuant to a binding contract described in § 1.1502-20T(g)(3) that was entered into on or after

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March 9, 1990 and before November 19, 1990).

The certification under this paragraph (e)(3)(i) with respect to the application of § 1.1502-20T to any transaction described in this paragraph (e)(3)(i) may not be withdrawn and, if the certification is filed, § 1.1502-20T must be applied to all such transactions on all returns (including amended returns) on which such transactions are included.

(ii) *Time and manner of filing certification.* The certification described in paragraph (e)(3)(i) of this section must be made in a separate statement entitled “[insert name and employer identification number of common parent] hereby certifies under § 1.337(d)-1 (e)(3) that the group of which it is the common parent is applying § 1.1502-20T to all transactions to which that section otherwise applied by its terms.” The statement must be signed by the common parent and filed with the group’s income tax return for the taxable year of the first disposition or deconsolidation to which the certification applies. If the separate statement required under this paragraph (e)(3) is to be filed with a return the due date (including extensions) of which is before November 16, 1991, the statement may be filed with an amended return for the year of the disposition or deconsolidation that is filed within 180 days after September 13, 1991. Any other filings required under § 1.1502-20T, such as the statement required under § 1.1502-20T(f)(5), may be made with the amended return, regardless of whether § 1.1502-20T permits such filing by amended return.

[T.D. 8319, 55 FR 49031, Nov. 26, 1990, as amended by T.D. 8364, 56 FR 47389, Sept. 19, 1991; 57 FR 53550, Nov. 12, 1992; T.D. 8560, 59 FR 41674, 41675, Aug. 15, 1994; T.D. 8597, 60 FR 36679, July 18, 1995; T.D. 9424, 73 FR 53947, Sept. 17, 2008]

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§ 1.337(d)-2 Loss limitation rules.

(a) *Loss disallowance*—(1) *General rule.* No deduction is allowed for any loss recognized by a member of a consolidated group with respect to the disposition of stock of a subsidiary. However, for transactions involving loss shares of subsidiary stock occurring on or

after September 17, 2008, see § 1.1502-36. Further, this section does not apply to a transaction that is subject to § 1.1502-36.

(2) *Definitions.* For purposes of this section:

(i) The definitions in § 1.1502-1 apply.

(ii) *Disposition* means any event in which gain or loss is recognized, in whole or in part.

(3) *Coordination with loss deferral and other disallowance rules.* For purposes of this section, the rules of § 1.1502-20(a)(3) apply, with appropriate adjustments to reflect differences between the approach of this section and that of § 1.1502-20.

(4) *Netting.* Paragraph (a)(1) of this section does not apply to loss with respect to the disposition of stock of a subsidiary, to the extent that, as a consequence of the same plan or arrangement, gain is taken into account by members with respect to stock of the same subsidiary having the same material terms. If the gain to which this paragraph applies is less than the amount of the loss with respect to the disposition of the subsidiary’s stock, the gain is applied to offset loss with respect to each share disposed of as a consequence of the same plan or arrangement in proportion to the amount of the loss deduction that would have been disallowed under paragraph (a)(1) of this section with respect to such share before the application of this paragraph (a)(4). If the same item of gain could be taken into account more than once in limiting the application of paragraphs (a)(1) and (b)(1) of this section, the item is taken into account only once.

(b) *Basis reduction on deconsolidation*—

(1) *General rule.* If the basis of a member of a consolidated group in a share of stock of a subsidiary exceeds its value immediately before a deconsolidation of the share, the basis of the share is reduced at that time to an amount equal to its value. If both a disposition and a deconsolidation occur with respect to a share in the same transaction, paragraph (a) of this section applies and, to the extent necessary to effectuate the purposes of this section, this paragraph (b) applies following the application of paragraph (a) of this section.